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PP RUEHWEB

DE RUEHAK #0215/01 0411655
ZNY CCCCC ZZH
P 101655Z FEB 09
FM AMEMBASSY ANKARA
TO RUEHC/SECSTATE WASHDC PRIORITY 8743
INFO RHEHAAA/NSC WASHDC PRIORITY
RUEATRS/TREASURY DEPT WASHDC PRIORITY

C O N F I D E N T I A L ANKARA 000215

SIPDIS

EEB/IFD/OMA FOR ANDY SNOW, TREASURY FOR FRANCISCO PARODI

E.O. 12958: DECL: 02/09/2019
TAGS: [EFIN](#) [ECON](#) [TU](#)
SUBJECT: NO ERDOGAN VALENTINE FOR THE IMF

REF: A. ANKARA 153
[B](#). ANKARA 122
[C](#). ANKARA 68

Classified By: Economic Counselor Dale Eppler for reasons 1.4(b,d)

[1](#)1. (C) Summary. In recent discussions with GOT officials and private sector contacts, we heard disparate views on whether or not Prime Minister Erdogan wants a stand-by arrangement (SBA) with the IMF. It is clear, as always, that the ultimate decision will be made by Erdogan. Factors in his decision include the March 29 municipal elections, alternate sources of funding for the GOT and Turkish private sector, the state of the Turkish and world economies, and market reaction to Turkey's actions. All our GOT contacts said a deal would be positive for the Turkish economy, adding the GOT and IMF are not far apart on a compromise. No one on the GOT's payroll is willing to point out what we see as obvious--this is now fully a political decision. While GOT and Central Bank (CBRT) sources are still bullish on a deal, every day of delay makes a deal seem a little less likely. End Summary.

[1](#)2. (C) Evren Dilekli, Treasury IMF Desk Officer, confirmed the unresolved issues are improvement of tax collection and auditing, local government reform (IMF wants fewer handouts to municipalities), and continued cuts in ongoing fiscal programs. While the reported distance between a deal is only 0.3% of GDP, all three of these reform areas are non starters for Erdogan and the AKP six weeks before an election. Our Treasury and Central Bank contacts said there were issues of communication, preparation, and negotiations with the IMF Mission in January. Relations over the last five years had gone relatively smoothly, but GOT officials claimed the new IMF team that came in January had some rough spots and deficiencies. They complained it was like "starting from scratch" because the team was not fully briefed on details of the Turkish economy or Turkey's past IMF deals. Hakan Kara, CBRT's Director General for Research and Monetary Policy, said he has always been "involved and informed" during past negotiations with the IMF but he believes the IMF was keeping many details to itself during this round of talks. Kara noted that an IMF deal would help relieve Turkey's funding conditions, adding the amount doesn't matter much but its catalyzing impact is important. Kara said he was a fan of IMF deals because an IMF agreement or review is useful to the GOT since it "leads to greater coordination between Turkish institutions."

[1](#)3. (C) In a February 3 meeting with investors organized by HSBC, we heard that investors have fully priced in a deal with the IMF and expect its announcement in February. Of a dozen visiting investors, only one was optimistic about Turkey's short-term prospects. Others expect that Turkey will do well in the medium to long term, but added that Erdogan's brinksmanship with the IMF makes Erdogan "difficult to invest in."

14. (C) Ismail Koksall, Secretary General of TOBB, the Turkish Union of Chambers and Commodity Exchanges, painted a dire picture of a weakening economy with drops in services, manufacturing, and employment and an immediate need for alternate financing for Turkish companies. Koksall said the IMF is "confused and does not have the real picture of Turkey in 2009." Koksall said IMF money could help cut back on corporate rollover needs, and money coming in from the IMF would have a pass-through effect to release more liquidity throughout the economy. He said an IMF deal would "restore confidence in Turkey, both domestically and abroad" and give Turkey more chits in the world economy confidence game. Koksall added that it remains to be seen if an IMF deal would restore enough confidence for banks to resume lending and open credit channels. There are creditworthy companies in Turkey, but skittish banks are calling loans early and shrinking their balance sheets to stay solvent and reduce risk.

15. (C) Coskun Cangoz, Treasury Director General for Public Finance, was "cautiously optimistic" about a deal with the IMF, adding that it would be a big vote of support for Turkey's economic management. He noted that channeling some of the money to the real sector would be tough, because bankers have concerns about making new loans and expect to see more non-performing loans. Cangoz confirmed that Treasury would likely use the fund money to decrease its borrowing needs. This would reduce the government's crowding-out effect and free up money for private sector borrowers. Cangoz and CBRT's Kara both said that banks need and want a guarantee mechanism from the GOT before they will be willing to channel more funds to the private sector,

especially small and medium companies.

16. (C) Reftel A describes PM Erdogan's comments that it "would not be the end of the world" if a deal was not signed with the IMF. On February 9, he upped his rhetoric by saying the IMF must compromise with Turkey's interests, or "we will pay our \$8 billion debt to the IMF and continue on our path." While this seems dramatic, it is possible. The obvious source for repayment would be Treasury's foreign exchange accounts at the CBRT. By paying off its IMF debt, Turkey would end its debtor-credit relationship with the IMF.

17. (C) Comment: Our recent discussions show there is little technical distance between the GOT and the IMF, with most of the impasse a matter of politics. PM Erdogan is viewing the IMF with a political eye on March 29 elections in which the AKP hopes to win more popular support. What is not clear yet is if Erdogan's threat that the IMF must compromise or the GOT will repay its debt and end the relationship is only for elections or for any deal this year. Erdogan might change his tone if markets penalize Turkey with a massive pullout, significant devaluation of the lira, or if fundamentals continue to degrade. The question then would be whether the IMF is still interested in a deal with Turkey and whether the IMF still has sufficient funds available to lend. End comment.

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